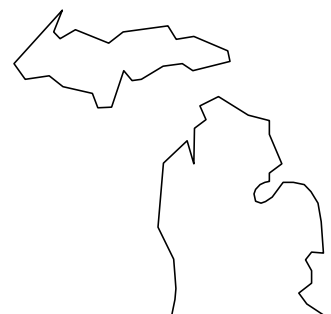


DEPARTMENT OF COMMUNITY HEALTH

AUDIT OF PERSONAL SERVICES CONTRACTS

Office of Audit  
Special Audits, Review and Compliance Section  
April 2005





JENNIFER M. GRANHOLM  
GOVERNOR

STATE OF MICHIGAN  
DEPARTMENT OF COMMUNITY HEALTH  
OFFICE OF AUDIT  
400 S. PINE; LANSING, MI 48933

JANET OLSZEWSKI  
DIRECTOR

April 20, 2005

Ms. Janet D. Olszewski, Director  
Department of Community Health  
Lewis Cass Building  
Lansing, MI 48909

Dear Ms. Olszewski:

This is our report on our audit of personal services contracts for the period from October 1, 2001 to December 17, 2002.

This report contains an introduction; audit scope and methodology; objective, conclusion, findings and recommendations.

We appreciate the courtesy and cooperation extended to us during this audit.

Sincerely,

A handwritten signature in black ink, reading "James B. Hennessey".

James B. Hennessey, Director  
Office of Audit  
Internal Auditor

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# **DEPARTMENT OF COMMUNITY HEALTH AUDIT OF PERSONAL SERVICES CONTRACTS**

## **INTRODUCTION**

The Guide to State Government issued by the Department of Management and Budget (DMB) contains procedures governing the procurement of services. These procedures include 0510.01, Quick Purchase Program; 0510.08, Agency Contract Administrators; 0510.13, Procurement of Services; 0510.15, Procuring Direct Human Services and Medical Services – General; 0620.01, Obtaining State Administrative Board Approval; 0620.02, Submissions to the Finance and Claims Committee; and 0630.01, Acquiring Consulting Services. Regulation 7.01 issued by the Department of Civil Service (Civil Service) contains procedures for obtaining Civil Service approval for making disbursements for personal services outside of the classified work force. The Office of State Employer (OSE) issued a directive dated September 3, 2002, requiring additional approval for contracting with employees who retired under the special early out retirement program. The Department of Community Health (DCH), Contract Management Section, also utilizes a contracts manual, that in part, governs the processing and monitoring of personal services contracts. DCH also adopted a policy dated September 19, 2002, prohibiting the contracting with specific early out retirees, except in cases of an early retiree possessing a unique expertise or knowledge of a specific critical departmental project.

## **AUDIT OBJECTIVE**

Our audit of the personal services contracts had the following objective:

To assess whether DCH's Central Office internal control processes and procedures over its contracting, purchasing, and expenditure processing for personal services contracts were effective to ensure compliance with applicable laws, regulations, rules, policies and/or procedures.

## **AUDIT SCOPE AND METHODOLOGY**

Our audit scope included an examination of DCH Central Office personal services contracts for FY 2002 and 2003. We reviewed relevant DMB, Civil Service and DCH policies and procedures. We examined the processing of 21 judgmentally selected contracts for adherence to applicable guidelines, rules and regulations. We also interviewed selected staff from the Contract Management Section, DCH Budget and Finance Administration, Budget and Contracts Division.

We judgmentally selected five contracts from FY 2002 to determine that disbursements did not exceed the maximum amounts that had been authorized.

We judgmentally selected five contracts from FY 2002 to determine if the contracts were being managed in accordance with DMB Procedure 0510.08 and the requirements set forth in the DCH Contracting Manual.

We judgmentally selected 24 persons from a listing of persons who had access on GroupWise through DCH that we were unable to identify as being a DCH employee, having a personal services contract with DCH or an employee of a company that had a personal services contract with DCH to determine if any disbursements were being made contrary to applicable DMB, Civil Service and DCH policies and procedures.

## CONCLUSIONS, FINDINGS AND RECOMMENDATIONS

**Objective:** To assess whether DCH's Central Office internal control processes and procedures over its contracting, purchasing, and expenditure processing for personal services contracts were effective to ensure compliance with applicable laws, regulations, rules, policies and/or procedures.

**Conclusion:** DCH's internal control processes and procedures were generally effective in ensuring that services were contracted and monitored in accordance with DMB, Civil Service, and DCH policies and procedures. However, we found several instances where personal services contracts were not properly disclosed nor executed in accordance with established policies and procedures (Finding 1), minor exceptions relating to contract processing (Finding 2), and failure to consistently complete post contract reviews and evaluations (Finding 3).

### **Finding**

#### **1. Undisclosed and Improperly Authorized Personal Service Contracts**

DCH did not adequately disclose all of its personal services contracts and did not comply with DMB, Civil Service, and DCH procedures in entering into these arrangements.

DMB Procedure 510.13, Procurement of Services, describes the procedures that apply to the procurement of all commodities and services that fall under the jurisdiction of Acquisition Services. These procedures are mandated for the procurement of commodities and services for all state Departments. While the DMB, Office of Purchasing (OOP) may have established central approval requirements for certain services and commodities (frequently services under \$25,000), procurements without this designation must be approved by OOP prior to the processing of the requisition. The procedures also require the prior written approval of the Civil Service Commission before any funds can be dispersed to pay for services performed by an independent contractor.

Rule 7-1 of the Michigan Civil Service Rules states, “An appointing authority shall not make or authorize disbursements for personal services outside of the classified service until the provisions of article 11, section 5, of the constitution and the civil service rules and regulations have been complied with in every particular.” Chapter 7 further requires that Civil Service approval is required for all personal service contracts unless the particular service has been pre-approved by Civil Service. Civil Service has preauthorized disbursements for personal services for those types of services that are not found in the various State of Michigan employment classifications. Civil Service has also preauthorized disbursements for personal services provided by a vendor if the disbursements do not exceed \$5,000 in one fiscal year as meeting Standard A (temporary, intermittent or irregular personal services).

The DCH Contract Management Section has the responsibility for all personal services agreements and purchase orders for services. The process begins with DCH-0016, Request for Contractual Services, along with a Request for Civil Service Approval (CS-138) if necessary. The Contract Management Section will then obtain any necessary Civil Service, DMB and State Administrative Board approvals.

As a result of our examination, we identified four instances where DCH did not adequately identify the contractual arrangements it had used to secure personal services of individuals to perform services on its behalf and had not received approval by either Civil Service or DMB. In all four cases the funds were disbursed or paid to four Community Mental Health Service Programs (CMHSPs). CMHSPs are under contract with the Department to provide mental health services to qualified recipients. The amounts were paid as part of the contract and the payments were classified and reported as categorical funds. Categorical funds within a CMHSP’s budget specify that the funds may only be used for a specific purpose and any unspent funds must be returned to DCH. Three of the CMHSPs received 100% funding from DCH, which included administration in two cases. The fourth CMHSP was required to pay 10% of the funding with DCH responsible for 90% of the funding.

While all four of these individuals were employed by the respective CMHSP, all were physically housed at DCH offices and were performing personal services on behalf of and under the direction of DCH. An examination of the details of the categorical funding revealed the following:

- Two of the persons' work involved programs affecting designated regions of the State of Michigan and two of the persons' work involved programs covering the entire State of Michigan.
- The statement of work for one of the individual stated: "...Act as the primary contact at the Michigan Department of Community Health for the integration of..."
- All of the work performed was for services requested/preformed for DCH central office.
- None of the types of services provided was included on the Civil Service listing of Pre-Authorized Services.
- All of the amounts paid under the categorical funding exceeded \$25,000.
- The workstations for the persons performing these personal services under the CMHSP categorical funding were all located at DCH offices in Lansing, not the CMHSP offices receiving the categorical funding. One of these individual's categorical funding included building space and computer service funding for the CMHSP; however, the individual was based in DCH's Lansing offices.

The use of categorical funding in a CMHSP budget to procure personal services on behalf of DCH clearly circumvents DMB and Civil Service policies and procedures regarding the disbursements for personal services prior to receiving the necessary approvals. This practice also permits DCH to obtain services without benefit of competitive bids and also creates the potential for conflicts of interest between DCH and CMHSPs.



## **Recommendation**

We recommend that DCH discontinue its practice of using categorical funding within a CMHSP budget to make disbursements for personal services performed directly on behalf of DCH, or in the alternative, obtain both Civil Service and DMB approval, in writing, that the use of such categorical funding does not violate any of their policies and procedures, or statutory requirements.

## **Finding**

### **2. Contract Processing**

DCH did not always ensure that it obtained the necessary approvals before services were provided and DCH did not always ensure that the vendor received a departmental purchase order before expenses were incurred.

DMB Procedure 0510.13, Procurement of Services, provides in part: “a written contract must be agreed to and signed by all parties before expenses are incurred, or, if a departmental purchase order is used, the DPO must be received by the vendor before expenses are incurred.”

Our review of 21 contracts/purchase orders for personal service disclosed one instance where the service was performed without prior approval. The services were for a speaker at a conference held on October 3, 2002. Departments have been granted authority to directly procure this type of service without further approval from Civil Service and DMB has delegated authority to the Departments for purchases up to \$25,000. Since the amount was under \$25,000, only appropriate DCH approval was required. DCH utilizes the DCH-0016 form in order to obtain appropriate approvals prior to preparation of the purchase order. The DCH-0016 was not initiated until October 17, 2002, and did not receive final approval until October 24, 2002. The purchase order was not initiated and approved until October 25, 2002, well after the service date of October 3, 2002.

By not obtaining prior approval and communicating the terms of the engagement to the vendor prior to services being provided, both parties are at risk if there is any misunderstanding concerning the services to be provided and the cost of providing those services.

### **Recommendation**

We recommend that DCH ensure that a written contract be agreed to and signed by all parties before expenses are incurred, or, if a purchase order is used, that the PO be received by the vendor before the expenses are incurred. In addition, appropriate approvals should be obtained before the services are actually rendered.

### **Finding**

#### **3. Post Contract Reviews and Evaluations**

DCH did not consistently perform post contract reviews and evaluations of its personal services contracts as required by DMB and DCH procedures.

DMB Procedure 0510.08, Agency Contract Administrators, requires the administrator to document that the objectives of the project have been addressed and to write a post contract review and evaluation. The administrator must submit copies of the post contract review to the department procurement office prior to final payment. The DCH Contract Manual indicates that the contract manager is to complete a written post contract or post agreement evaluation that highlights agreement objectives and results noting any special circumstances, improvements for the future, or lessons learned.

We judgmentally selected five personal service contracts performed during FY 2002. Our examination disclosed that four of the five contracts did not have any documentation that a post contract review was performed. All five administrators, including the one who completed a post contract review, informed us that they were not aware of the requirement to prepare a post contract review.

Having evaluations completed and available for review would provide valuable feedback to other areas of the Department should this same contractor be considered for other services.

**Recommendation**

We recommend that DCH ensure that post contract written evaluations are performed for its personal services contracts.

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<b>Finding Number:</b>	One
<b>Finding Title:</b>	Undisclosed and Improperly Authorized Personal Service Contracts
<b>Recommendation:</b>	We recommend that DCH discontinue its practice of using categorical funding within a CMHSP budget to make disbursements for personal services performed directly on behalf of DCH, or in the alternative, obtain both Civil Service and DMB approval, in writing, that the use of such categorical funding does not violate any of their policies and procedures, or statutory requirements.
<b>Comments:</b>	The Mental Health and Substance Abuse (MHSA) Administration agrees with the finding and recommendation. This practice apparently started in the former Department of Mental Health in the early 1990s, and continued after the formation of the Department of Community Health.
<b>Corrective Action:</b>	The MHSA Administration has already taken steps to reduce/eliminate the use of such contracting mechanisms. There are currently two remaining agreements, and plans are being developed to phase out these arrangements by the end of FY 2005.
<b>Anticipated Completion Date:</b>	October 1, 2005
<b>Responsible Individual:</b>	Patrick Barrie

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<b>Finding Number:</b>	Two
<b>Finding Title:</b>	Contract Processing
<b>Recommendation:</b>	We recommend that DCH ensure that a written contract be agreed to and signed by all parties before expenses are incurred, or, if a purchase order is used, that the PO be received by the vendor before the expenses are incurred. In addition, appropriate approvals should be obtained before the services are actually rendered.
<b>Comments:</b>	The Bureau of Budget and Audit, Contract Management Section agrees with this finding.
<b>Corrective Action:</b>	Contract Management Section will continue to emphasize obtaining executed personal services agreements and/or purchase orders in advance of incurring agreement expenses through an instructional memorandum to Department Management staff. In addition, we will emphasize this requirement in our policies and procedures for personal services agreements on the intranet.
<b>Anticipated Completion Date:</b>	June 1, 2005
<b>Responsible Individual:</b>	Kristi Broessel

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<b>Finding Number:</b>	Three
<b>Finding Title:</b>	Post Contract Reviews and Evaluations
<b>Recommendation:</b>	We recommend that DCH ensure that post contract written evaluations are performed for its personal services contracts.
<b>Comments:</b>	The Bureau of Budget and Audit, Contract Management Section agrees with this finding. However, we have a centralized oversight role in the purchasing processes and do not have direct responsibility for the development, implementation, monitoring and evaluation of personal services agreements. The responsibility for completing evaluations for agreements resides with the Department's contract administrators/managers.
<b>Corrective Action:</b>	Contract Management Section will provide sample evaluation documents, instructions, policy and procedures through the intranet to Department contract administrators/managers. In addition, Contract Management Section will provide training and technical assistance as needed. Personal Services Agreement evaluations will be in effect for Fiscal Year 2004-05 agreements and will be due in December following the end of the agreement's fiscal year. Evaluations will be retained in the contract administrators/managers agreement files for review.

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**Finding Number:** Three (continued)

**Anticipated Completion Date:** December 30, 2005

**Responsible Individual:** Kristi Broessel